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IN THE

Supreme Court of the United States

OCTOBER TERM, ~~1952~~ 1953

No. ~~702~~ 33

IN THE MATTER

of

THE FLORIDA EAST COAST RAILWAY CO.,
Debtor,

S. A. LYNCH, S. A. LYNCH CORPORATION, *et al.*,
Petitioners,

v.

ATLANTIC COAST LINE RAILROAD COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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Dated: April 8, 1953.

INDEX.

	PAGE
JURISDICTION TO REVIEW	2
OPINIONS BELOW	2
QUESTIONS PRESENTED	2
STATEMENT	3
Summary of Earlier Proceedings	4
The Reopened Proceedings Before the Commission	6
The Proceedings Before The District Court	7
Decision by Court of Appeals	8
REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT	9
I. The decision below conflicts with decisions of this Court concerning the relative functions of Commission and District Judge	9
II. The decision below conflicts with decisions of this Court in substituting the judgment of the Appellate Court for that of the District Judge	15
III. The decision below conflicts with decisions of this Court relating to the rule of absolute priority	17
APPENDIX	1a

Table of Cases.

	PAGE
Atlantic Coast Line Railroad Company v. *St. Joe Paper Company*, 201 F. (2d) 325	2, 11
Atlantic Coast Line Railroad Co. et al. v. *St. Joe Paper Co. et al.*, 339 U. S. 929	6
Atlantic Coast Line R. Co. v. *St. Joe Paper Company*, 179 F. (2d) 538	2, 5, 6, 10, 16, 19
Comstock v. *Group of Institutional Investors*, 335 U. S. 221 (1948)	13, 18
Consolidated Rock Products Co. v. *Du Bois*, 312 U. S. 510 (1941)	20
Ecker v. *Western Pacific R.R. Co.*, 318 U. S. 448	10, 12
Florida East Coast Railway Company Reorganization, 267 I. C. C. 295 and 729	2, 5, 20
Florida East Coast Railway Company Reorganization, 282 I. C. C. 81 and 282 I. C. C. 195	2, 6, 18, 19, 20
Group of Institutional Investors v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523 (1943)	12, 17, 20
In re Denver & Rio Grande Western Railroad Co., 150 F. (2d) 28 (1945), rev'd on other grounds, 328 U. S. 495 (1946)	17
In re Florida East Coast Railway Company, 103 F. Supp. 825	2, 7
In re Florida East Coast Railway Company, 81 F. Supp. 926	2, 5
In re Florida East Coast Railway Co., 52 F. Supp. 420, 424	4
In re Florida East Coast Ry. Co., 103 F. Supp. 825	7, 18
New England Coal and Coke Co. v. *Rutland R.R.*, 143 F. (2d) 179	22
Northern Pacific Railway Co. v. *Boyd*, 228 U. S. 482	19, 20

PAGE

Old Colony Bondholders, et al. v. *New York, N. H. & H. R. Co.*, 161 F. (2d) 413 (1947) 14

Palmer v. *Massachusetts*, 308 U. S. 79, 87 (1939) 12

Warren v. *Palmer*, 310 U. S. 132, 138 (1940) 12

STATUTES.

Bankruptcy Act, 11 U. S. C. 205, 49 Stat. 911
Section 77 ..... 2, 3, 7, 12, 16, 21, 22
Section 77 (e) 2, 9, 11, 21, 23, 1a

United States Code, Title 28,
Section 1254 2

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, S. A. Lynch, S. A. Lynch Corporation and certain others, acting together for the protection of their interests as owners of First and Refunding bonds of Florida East Coast Railway Company, respectfully pray for a writ of certiorari to the Court of Appeals for the Fifth Circuit to review a judgment, entered in this cause on January 19, 1953, reversing an order of the District Court for the Southern District of Florida disapproving a

plan of reorganization for Florida East Coast Railway Company under Section 77 of the Bankruptcy Act, 11 U. S. C. 205, 49 Stat. 911.

The record, consisting of six volumes numbered I to VI, inclusive, is now before this Court upon petition for certiorari by St. Joe Paper Company, *et al.*, No. 670, October Term 1952. This record is made a part hereof by reference, in support of this petition.

Jurisdiction to Review.

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254.

Opinions Below.

The opinion of the Court of Appeals is reported in *Atlantic Coast Line Railroad Company* v. *St. Joe Paper Company*, 201 F. (2d) 325; R. Vol. II, 717; the opinion of the District Court is reported in *In re Florida East Coast Railway Company*, 103 F. Supp. 825; R. Vol. I, 127; the decisions of the Interstate Commerce Commission relating to the 1951 plan here involved are reported in *Florida East Coast Railway Company Reorganization*, 282 I. C. C. 81 and 282 I. C. C. 195; R. Vol. I.

The earlier decisions relating to the 1948 plan are reported as follows: opinion of the Court of Appeals, *Atlantic Coast Line R. Co.* v. *St. Joe Paper Company*, 179 F. (2d) 538; opinion of the District Court, *In re Florida East Coast Railway Company*, 81 F. Supp. 926; opinion of the Interstate Commerce Commission, *Florida East Coast Railway Company Reorganization*, 267 I. C. C. 295 and 729.

Questions Presented.

1. In reviewing the decision of a district judge under Section 77(e) of the Bankruptcy Act that a plan of reorgan-

ization does not comply with applicable legal standards, may a Court of Appeals

(i) confine the functions of the district judge to a determination of constitutional questions, and

(ii) ignore the findings and conclusions of the district judge, made after hearing, and substitute its own judgment therefor?

2. Does the rule of absolute priority permit the enforced sale of a debtor's property for securities of a third party having a value substantially less than the value of the property required to be sold?

3. Does the due process clause of the Fifth Amendment permit the adoption of a plan of reorganization requiring the enforced sale of a debtor's property to a third party at a valuation made contrary to applicable legal standards and even as so established, greater than the value of the securities to be paid therefor?

4. Does Section 77 empower the Commission to certify a plan that requires an involuntary merger of a debtor in reorganization with a third party carrier previously unrelated to the debtor?

Statement.

The Interstate Commerce Commission has proposed a plan of reorganization under Section 77 of the Bankruptcy Act requiring that the entire properties of the debtor, an independent railroad, be sold to another carrier. Substantially all of the affected security holders of the debtor have opposed the enforced sale of their properties on the terms and conditions proposed. The District Court having jurisdiction of the proceeding since its inception has found that the plan violates applicable legal standards in many

respects. Nevertheless, the Court of Appeals, by a divided vote of 3 to 2, substituted its judgment for that of the District Court as to specific findings and directed that the District Court approve the plan.

Petitioners, who have been in this proceeding since 1938, are interested only in fair and equitable treatment for the Refunding bondholders. Their position throughout has been independent of that of either of the two major parties.

Summary of Earlier Proceedings.

The debtor entered Section 77 proceedings in 1941 from a preceding equity receivership. Its unsecured debt is small and its stock is without value. All are agreed that its First Mortgage bonds should be paid in full. This leaves only the treatment of the Refunding bonds, which are outstanding in the amount of $45,000,000 with unpaid interest of $37,125,000, as the central problem of any plan.

The Commission's 1942 plan (252 I. C. C. 423 and 731) was disapproved by the District Court and referred back to the Commission for "an opportunity to re-examine the entire situation in the light of the facts which have developed since the former hearing", *In re Florida East Coast Railway Co.*, 52 F. Supp. 420, 424.

After further hearings, the Commission proposed its 1945 plan, in which it rejected an offer by Atlantic Coast Line Railroad to acquire the debtor or its property, pointing out that since the securities proposed to be issued by Atlantic Coast Line for the property did not satisfy the claim of the Refunding bondholders, the latter must be given the entire equity in the reorganized company to provide for recoupment (261 I. C. C. 151, 192).

Thereafter, the Commission received representations from Atlantic Coast Line that control of the reorganized debtor by St. Joe Paper Company, a holder of a majority of the Refunding bonds, would not be in the public interest.

Further hearings were held. After long preoccupation with the question of control, with very little attention to the problems of fair and equitable treatment,* the Commission by a split vote of 5 to 4, issued its 1947 plan. This provided for an enforced sale of the debtor's properties to Atlantic Coast Line for a price of $40,500,000, payable partly in cash but principally in face amount of various classes of securities of Atlantic Coast Line (267 I. C. C. 295). Following reargument and re-consideration, the Commission issued its 1948 plan of substantially similar effect, this time by a split vote of 6 to 5 (267 I. C. C. 927).

After hearings before the District Court, Circuit Judge Sibley, sitting as District Judge designate, disapproved the plan, on the ground, among others, that it was unfair and inequitable, *In re Florida East Coast Railway Company*, 81 F. Supp. 926.

This disapproval was upheld by the Court of Appeals, *Atlantic Coast Line R. Co.* v. *St. Joe Paper Company*, 179 F. (2d) 538. That court pointed out that over a period of eight years the Commission "has changed and vacillated, and vacillated and changed, and vacillated again" and that "it seems in desperation to have seized upon the Coast Line offer as its only way out" (179 F. 2d, 538, 544).

The Court of Appeals stated that, if it appeared to the trial judge that the Commission had unfairly cut down the legal rights of the bondholders to fit them into the Atlantic Coast Line public interest pattern, the judge was "not only authorized but required to disregard the Commission's findings, that the plan was fair and equitable, in favor of his own, that the plan was not." Also, that "it would be

* As found by both the District Court and the Court of Appeals for the Fifth Circuit (see *In the Matter of Florida East Coast Railway Company*, 81 F. Supp. 926, 933; *Atlantic Coast Line Railway Company* v. *St. Joe Paper Company*, 179 F. (2d) 538, 544).

our duty to accord full weight to his conclusions" (179 F. 2d 538, 543).

An application by Atlantic Coast Line for a writ of certiorari was denied, *Atlantic Coast Line Railroad Co. et al. v. St. Joe Paper Co. et al.*, 339 U. S. 929.

The proceedings again went back to the Commission.

The Reopened Proceedings Before the Commission.

After further hearings, the Commission by a divided vote of 7 to 3, issued its 1951 plan, again providing for a forced sale of the debtor's properties to Atlantic Coast Line.

The 1951 plan was substantially identical to the disapproved 1948 plan. The principal difference was an increase of $6,000,000 in face amount of securities to be paid by Atlantic Coast Line, which was the entire recognition given to an increase of $800,000 in estimated earning power and to an annual credit of $462,000 for unification savings (282 I. C. C. at 158-160).

This increase was commented upon in the dissenting opinion of Commissioner Mahaffe (282 I. C. C. 81, 190):

> "as a matter of fact the increase of some $6,000,000 in the purchase price found necessary at this time accentuates the inherent unfairness of the plan. Had the plan of 1947 been consummated such increase in value would have inured largely to the Coast Line security holders. This would have been the result of divesting the creditors of the debtor of their property on the basis of value derived from estimates of future normal year earnings. Estimates as now presented by the various parties vary by nearly 1 million dollars. Clearly no such inequitable result could occur under an internal reorganization in which the entire interest in the debtor's property would be turned over to its creditors. Yet it is impossible at this time, on the basis of the most recent estimates of future normal earnings of the debtor, to exclude

> the possibility, or even the probability of future further changes in the value of the debtor's property."

Although opposed by substantially all of the creditor parties, who pointed out in their briefs that the 1951 plan was less fair to the Refunding bondholders than the 1948 plan, the plan proposed by the Commission was certified to the District Court.

The Proceedings Before The District Court.

Elaborate hearings, lasting a full week, with four days devoted to testimony, were held by the District Court (R. Vol. II, 247-659). Circuit Judge Strum, who has had charge of the proceedings since their inception, sat as District Judge *pro hac vice*. The principal creditor parties not only unanimously opposed approval of the plan, but joined in a motion to dismiss the proceedings and to reinstate the earlier equity proceedings. In support of this motion, they filed a copy of an agreed plan of internal reorganization, in contrast to a sale to a third party, which they undertook to support in an equity reorganization (R. Vol. I, 25-39).

The District Court concluded that the plan should be disapproved, the Section 77 proceedings dismissed and the equity proceedings reinstated (R. Vol. I, 168). The decision was accompanied by an extensive opinion which fully and carefully analyzed the evidence, the Commission's proposals and the objections thereto (R. Vol. I, 127; *In re Florida East Coast Ry. Co.*, 103 F. Supp. 825). In essence, the District Court concluded, in the exercise of his informed discretion, that the 1951 plan retained "the basic inequities" for which the 1948 plan had been rejected (103 F. Supp. 825, 832; R. Vol. I, 1937). The Court of Appeals made no finding of an abuse of discretion.

Among the defects pointed out by Judge Strum were:

(a) failure of the Commission to give due consideration to the earning power of the debtor, in its findings as to normal annual income (103 F. Supp. 825, 836; R. Vol. I, 143);

(b) failure of the Commission to give due consideration to the earning power of the debtor in translating earning power into capitalizable value (103 F. Supp. 825, 837 *et seq.*; R. Vol. I, 147);

(c) requirement by the Commission of the reservation of $4,000,000 cash in capital reserve funds, to be turned over to Atlantic Coast Line for property improvements, thus offsetting the $4,000,000 cash to be paid by Atlantic Coast Line as part of the purchase price (103 F. Supp. 825, 838 *et seq.*; R. Vol. I, 149);

(d) failure of the Commission to give more than nominal effect to estimated unification savings by an increased allowance of only $500,000 instead of $7,337,000 which the Commission itself found was the debtor's share of their value (103 F. Supp. 825, 840; R. Vol. I, 153);

(e) failure of the Commission to permit the Refunding bondholders to recoup past losses through the additional income realizable in future years of higher earnings (103 F. Supp. 825, 841; R. Vol. I, 155-156);

(f) disregard of the rule of absolute priority as heretofore applied by this Court (103 F. Supp. 825, 842; R. Vol. I, 156-157).

Decision by Court of Appeals.

The appeal by Atlantic Coast Line was heard by the Court of Appeals en banc, five judges sitting. The sixth judge of that court, Judge Strum, had already disapproved

plan while sitting as District Judge. By a 3 to 2 decision, the court reversed Judge Strum and directed that plan be approved (201 F. 2d 325, 331; R. Vol. II).

The majority opinion is silent as to how the 1951 plan ets the defects of the 1948 plan condemned by the same art. Disregarding its earlier expression of views, the jority of the court below devote only five short paraaphs to the question of fair and equitable treatment, hout referring to a single one of the objections raised petitioners and upheld in detail by the District Court. hile referring specifically to one of the twelve supporting asons given by the District Judge for disapproving the n, the majority opinion deals with the fundamental consions and the remaining eleven supporting reasons by ostituting the judgment of the appellate court for that of trial court, holding that the findings of the trial judge re themselves without support in law or fact." Reasons this conclusion are not set forth.

It is this decision of which review is sought.

Reasons Relied on for the Allowance of the Writ.

I. The decision below conflicts with decisions of is Court concerning the relative functions of Commisn and District Judge.

The effect of the decision below would be to deprive a dist judge of his statutory functions under Section 77(e)* d to reduce his position to that of little better than a bber stamp, except for constitutional questions. The ajority opinion states at the outset that "except as to the estion of unconstitutional taking, it [Congress] had also nfided to the Commission the question of valuation" 01 F. 2d, 325-326).

* The relevant portions are set forth in the Appendix.

This position is in sharp contrast with the rule stated by this Court in *Ecker* v. *Western Pacific R.R. Co.*, 318 U. S. 448, that valuations of the Commission are final when reached "with material evidence to support the conclusion and in accordance with legal standards." In the same case this Court said that there is always open to the district court "the question of whether in reaching the result, the Commission had employed improper statutory standards", *ibid*, page 473.

The present position of the court below is an almost complete reversal of its position on the earlier appeal two years earlier. It then said (179 F. 2d, 538, 542):

> "The case we have here is that of one railroad company coveting, and pressing to possess, a competing debtor railroad company, against the wishes of 98 per cent of the equitable owners of the debtor * * *".
>
> "When, too, the concern of the courts with the interests of the owners and creditors of the debtor, evidenced by the 'absolute priority' rule, the rule of the *Boyd* case, 228 U. S. 482, is taken into consideration the conclusion becomes inescapable that where, as here, it appears that substantially all the creditors are arrayed against the plan, the act, requiring the judge to be satisfied before approving the plan, as fair and equitable, imposed upon the trial judge in this case a primary and most exacting duty."
>
> "This duty was, in according due weight to the determination of the commission on that issue, that the plan was fair and equitable to the bondholders, to subject the proceedings to the closest scrutiny, to find out whether this determination was lawfully and constitutionally arrived at * * *".
>
> "He should particularly seek to ascertain whether, as a result of this subordination and weighting, the determination of what is fair and equitable to the

bondholders has been reached at a sacrifice of the private interests in order to give effect to the proposed dominant public interest that Coast Line should have the properties."

Despite its clear statement two years ago, the court below has now overrruled the trial judge without regard to his elaborate analysis of the plan and his specific rulings thereon. In disapproving the plan, the District Judge stated 12 specific grounds for his disapproval, including failure to give due consideration to earning power, failure to apply proper and consistent standards of valuation, failure to give more than lip service to the crediting of unification savings, the plan requirement that $4,000,000 in cash be turned over to Atlantic Coast Line, and disregard of the rule of absolute priority. Despite these detailed supporting reasons given by the District Judge, the majority opinion below fails to refer to a single one of them.

Instead, the majority opinion states that the Commission's "finding that the plan was fair and equitable finds full support in the evidence" (201 F. 2d at 329). It then concludes that "It will, therefore, serve no useful purpose for us to take up one by one, as the appellants and appellees have done, to dissect and discuss them, the findings made and reasons given by the Commission, on the one hand, and those set out in the lengthy opinion of the trial judge, on the other * * *" (201 F. 2d, at 330).

Thus the majority below treated the Commission's action as conclusive because supported by some evidence. It disregarded completely the necessity for compliance with legal and statutory standards. It ignored the defects pointed out in detail by the District Judge.

Its decision effectively deprives the District Judge of the exercise of the duties placed upon him by Section 77 (e).

In so doing, the decision below is directly in conflict with the decision by this Court in which the relative functions of court and commission have been delineated.

In *Palmer* v. *Massachusetts*, 308 U. S. 79, 87 (1939) it was pointed out that the "judicial process in bankruptcy proceedings under §77 is, as it were, brigaded with the administrative process of the Commission". Again in *Warren* v. *Palmer*, 310 U. S. 132, 138 (1940) it was said:

> "The judicial functions of the bankruptcy court and the administrative functions of the Commission work cooperatively in reorganization."

That the brigading of the functions of Commission and court did not mean the practical elimination of review by the district judge was further clarified by this Court in subsequent decisions.

Ecker v. *Western Pacific R. R. Co.*, 318 U. S. 448 made it clear that the district court was expected to examine carefully the Commission's treatment of creditors to determine whether the statutory mandates had been followed.

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523 (1943) this Court remanded the plan to the Commission after finding that the treatment accorded the General Mortgage bondholders was not the equivalent of the rights surrendered, since it did not include compensation for loss of seniority. It said (p. 566):

> "Whether in a given case senior creditors have been made whole or received 'full compensatory treatment' rests in the informed judgment of the Commission and the District Court on consideration of all relevant facts."

As to whether full compensatory treatment was accorded, "The question in each case is one for the informed discretion of the Commission and the District Court" (at page 564). And again it was said that "the Commission and the District Court should determine what the General Mortgage bonds should receive" as compensatory treatment (at page 571).

In *Comstock* v. *Group of Institutional Investors*, 335 U. S. 221 (1948), it was held that the district court had authority to pass on objections to a plan that were not even raised before the Commission. This Court said (at p. 227):

> "In view of the functions cast upon the court in such cases, we cannot say that it may not, in its discretion, consider objections on their merits even though they have not been presented to the Commission. Some circumstances might be disclosed to indicate a remand for their consideration by the Commission. *They might indicate that the courts would withhold approval, not out of deference to the objecting parties' rights but because of the broad responsibility laid upon the court for the equity and fairness of the plan as a whole.* The court will be diligent to protect itself and the public from approval of unfair plans, even by default, and may take for its own use evidence no party would have a right to force upon it. The court below evidently considered the circumstances of this case to warrant such inquiry into the merits, and we do not inquire whether the discretion was wisely exercised." (Emphasis supplied.)

In contrast to the conclusions of this Court concerning "the broad responsibility" cast upon the district judge by the statute, the decision below would eliminate a very substantial part of the duties of the district judge concerning

applicable legal standards and, it is submitted, is in square conflict with prior decisions of this Court.

The Court of Appeals for the Second Circuit has taken the position that in the case of an enforced sale the scope of action of the district court is even broader than in the ordinary reorganization. In *Old Colony Bondholders, et al. v. New York, N. H. & H. R. Co.*, 161 F. (2d) 413 (1947), Old Colony Railroad, a subsidiary of New Haven Railroad, was in the same reorganization proceedings with the latter, and a joint plan of consolidation was proposed. Old Colony bondholders opposed the plan on the ground that a proper valuation had not been made by the Commission because a sale was involved. The Court of Appeals denied this contention, for the reason that Old Colony was a subsidiary and its properties were the same as though owned by the New Haven. It pointed out, however, that if a sale had been involved entirely different questions would have been presented (pp. 420-421):

> "• • • the appellant raises a number of objections to the Commission's appraisal. The first is that the finality of an appraisal by the Commission is limited to a true reorganization, that is, to one where the property for which the new securities are to be issued belongs to the debtor. Since in the case at bar the plan contemplates a sale of Old Colony assets to the reorganized New Haven, the appellant argues that the Commission could not lawfully proceed as it did, but must follow the doctrine applied in First Nat. Bank v. Flershem, 290 U. S. 504, 527, • • • *It is true that if the transfer of Old Colony assets is like a judicial sale on foreclosure or execution, the Commission's appraisal was not valid. But we think it is not.* • • • the properties of Old Colony are, for purposes of the plan, on the same footing with respect to the whole

> system as are lines securing a divisional mortgage of New Haven." (Emphasis supplied.)

The sole ground on which the Court of Appeals for the Second Circuit concluded that ordinary reorganization standards were not applicable, *i. e.*, that Old Colony was in effect a division of New Haven, is not present here. Atlantic Coast Line is a third party stranger, having no relationship to the debtor. The forced sale proposed by the Commission cannot be distinguished, in practical effect, from a foreclosure.

If this reasoning of the Court of Appeals for the Second Circuit is sound, it follows that not only does an enforced sale involve different standards of valuation, but that likewise different presumption attach to the Commission's action.

II. The decision below conflicts with decisions of this Court in substituting the judgment of the Appellate Court for that of the District Judge.

In reversing the District Judge, the Court of Appeals merely substituted its judgment for that of the District Judge, without explanation. Its conclusion on this point is explicit. The opinion states (201 F. 2d at 329):

> "unless an examination of the record shows, as we thought it did on the former hearing, that the bondholders will not receive under this plan the equivalent in value of what they will part with, the judgment must be reversed and the cause remanded to the district court with directions to approve the plan."

The opinion then states that the record has been examined and that the Commission's "finding that the plan was fair and equitable finds full support in the evidence" and that

"the Commission's findings and estimates * * * was most favorable to the bondholders of East Coast."

The position of the court below is almost a complete reversal of its position on the earlier appeal, where it upheld Judge Sibley in disapproving a substantially like plan. That court had earlier said (179 F. 2d, 538, 543):

> "It is quite clear, too, that in reviewing the findings of the trial judge upon such a record, it would be our duty to accord full weight to his conclusions that the plan was not fair and unless they are found, as a matter of law, to be wholly wrong, or, as matter of fact, to be clearly erroneous, these conclusions and the order based on them should be sustained."
>
> "* * * we are left in no doubt that the trial judge was right, for these reasons and for the other reasons that he gave, in disapproving the plan as not fair and equitable and not affording due recognition to the rights of the bondholders. Indeed, we are of the opinion that a contrary holding could not have been sustained and that the order declining to approve the plan and referring the proceeding back to the Commission must be affirmed."

Despite its earlier position, and without explanation the court below has now reversed the District Judge, apparently on the basis of its own conclusions and without regard to the detailed findings of the District Judge.

In so doing, the court below assumed to itself the functions of the District Judge. It disregarded, almost without comment, his findings and conlusions, and substituted its own judgment.

This action of the court below is in conflict with the scope of review heretofore applied by this Court and by other Courts of Appeal in cases under Section 77.

In *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific R.R. Co.*, 318 U. S. 523, 564, this Court said:

> "Our role on review is a limited one. It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task on review is at an end."

Again, in *Comstock* v. *Group of Institutional Investors*, *supra*, the Court said (335 U. S. at p. 228):

> "The court below evidently considered the circumstances of this case to warrant such inquiry into the merits, and we do not inquire whether the discretion was wisely exercised."

And in *In re Denver & Rio Grande Western Railroad Co.*, 150 F. (2d) 28, (1945), rev'd on other grounds, 328 U. S. 495 (1946), the Court of Appeals for the Tenth Circuit said (at p. 36):

> "On appeal, our scope of review is more limited than even that of the District Court. We inquire only to ascertain whether the District Court performed its judicial functions under Subsection (e) and whether its conclusions find support in the record. We may not reverse the District Court merely because we would have reached a different conclusion."

III. The decision below conflicts with decisions of this Court relating to the rule of absolute priority.

In still a third respect, the decision below is in conflict with applicable decisions of this Court, namely those relating to the rule of absolute priority.

This question was raised before the Commission and was referred to in the dissenting opinion by Commissioner Mahaffie as follows (282 I. C. C. 81, 189):

> "* * * although under the plan approved the creditors received much less 'in value than the face of their claims,' they were required to give up their interest in the debtor, including the right to control the property and accept securities of the Coast Line also having a value much less than the value determined for the property. In view of the inconsistency of this process, and the results obtained, with the doctrine of the *Boyd* case, *supra*, I am unable to accept the resulting subordination of the principles laid down as the authoritative test of what is fair and equitable to the Commission's conclusions as to what is required by the public interest."

The District Court reached an equally clear conclusion (103 F. Supp. 825, 842; R. Vol. I, 156):

> "The Coast Line, as an unsecured creditor, may not participate in the debtor's mortgaged assets which are less in value than the mortgage debt, unless the debt be paid in full, either in cash or in new securities of equal worth and having the same priority as the old securities to be displayed. Yet the effect of the fourth plan is to divest the 5% bondholders of their present equitable ownership of the mortgaged property and vest it in the Coast Line free of the mortgage lien, for a consideration less than the mortgage debt."

The point was ignored by the Court of Appeals, although in its earlier opinion it had been specifically recognized. Likewise the court below ignored its earlier statement that Atlantic Coast Line is a "railroad company coveting, and

pressing to possess, a competing debtor railroad company" (179 F. 2d, 538, 542).

The fact that Atlantic Coast Line has striven so long and so hard to acquire the debtor demonstrates that it expects to acquire a bargain, to pay less than the true value. This conclusion is supported by the Commission's own findings, i.e., that the debtor has a value of $46,500,000, for which Atlantic Coast Line would pay a consideration worth only $43,694,000 (282 I. C. C. at 162-163).

The absolute priority rule, enunciated in *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482, is applicable. There a reorganization contract was made between secured creditors and stockholders in which the property was valued and capitalized at $345,000,000, and the stockholders allowed to participate in the new company organized for the purpose of acquiring the assets of the old company. The contract was then consummated by a so-called foreclosure sale at which the property was sold for $61,500,000, which was less than the amount of the senior creditors' claims, thus "freezing out" the unsecured creditors. This Court held that the reorganization was fraudulent and void as to unsecured creditors, because they had been deprived of their rights in the company's property, which was a trust fund for the payment of creditors, 228 U. S. at page 504. If there were sufficient value to permit the stockholders to participate, there must have been sufficient value for the unsecured creditors. In that case the decision revolved around the fact that a mere distribution of the consideration received by the old company, namely the $61,500,000 for which its assets were sold, was fraudulent. This Court looked instead to the value of the property in the hands of the successor corporation and took that as the considera-

tion to be distributed, holding that the stockholders of the new company could not be permitted to gain at the expense of the creditors of the old.

A majority of the Commission has here done what was condemned by this Court in the *Boyd* case. The Commission has proposed a distribution among the Refunding bondholders of an amount representing the equivalent of the $61,500,000 distribution in the *Boyd* case that this Court held illegal. It has valued the property "for reorganization purposes" at $46,500,000, but has proposed a sale price of $43,694,086 (282 I. C. C. 81, 163). In its preoccupation with the public interest in the question of control, it has placed two different valuations upon the property, and thus disregarded the rule of absolute priority.

This Court said in the *Milwaukee* case, *supra*, quoting with approval its language in *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941), that the application of the rule of absolute priority "will be dependent on the facts and requirements of each case". It pointed out the necessity of preventing the property of one interest from being "subtly appropriated to pay the claims of another while lip service is rendered the principles of priority", 318 U. S. at p. 570.

Commission Mahaffie, speaking for the dissenting Commissioners in connection with the 1948 plan, well summarized the situation, which is still unchanged except as to figures (267 I. C. C. at p. 745):

> "• • • The report attributes to the Coast Line securities to be paid for the property a value of approximately $31,000,000. The question presented is whether the persons who normally would be entitled to receive the $40,500,000 of securities found by us to

be properly issuable, and the resulting control of the property may be required to give up that control and to accept instead Atlantic Coast Line securities having a value much less than that amount."

Respectfully submitted,

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APPENDIX

The pertinent provisions of Section 77(e) of the Bankruptcy Act are as follows (11 U. S. C. A. §205, 49 Stat. 911):

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept

such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received.

* * * * * *

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."